IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

IN RE	)	
JEFFERSON COUNTY, ALABAMA, a political subdivision of the State of Alabama,	)	Case No. 11-05736-TBB9 Chapter 9
Debtor.	)	

BRIEF OF THE BANK GROUP CONCERNING
SECTIONS 922 AND 928 OF THE BANKRUPTCY CODE

In compliance with this Court's Order of November 28, 2011, the Bank Group,[1] as defined by the Court on the record during the hearings of November 21 and 22, 2011, submits this brief regarding Sections 922 and 928 of the Bankruptcy Code in further support of the Motions.[2] The Bank Group incorporates by reference the Joinder filed by Certain Liquidity Banks in Support of the Motions (the *"Joinder"*) [Docket No. 239] and the Response and Memorandum of Supplemental Points of Syncora Guarantee Inc. to the Motions [Docket No.

1 The Bank Group consists of The Bank of Nova Scotia, Société Générale, New York Branch, State Street Bank and Trust Company, Lloyds TSB Bank plc, Regions Bank, The Bank of New York Mellon, Bank of America, N.A., JPMorgan Chase Bank, N.A., Syncora Guarantee, Inc., and Financial Guaranty Insurance Company.

2 Capitalized terms not otherwise defined herein shall have the meaning ascribed to such terms in (1) the EMERGENCY MOTION OF THE JEFFERSON COUNTY SEWER SYSTEM RECEIVER FOR (A) A DETERMINATION THAT THE RECEIVER SHALL CONTINUE TO OPERATE AND ADMINISTER THE SEWER SYSTEM PURSUANT TO THE RECEIVER ORDER OR (B) FOR RELIEF FROM THE AUTOMATIC STAY OR OTHER APPROPRIATE RELIEF [Docket No. 40] (the *"Receiver Motion"*), (2) EXPEDITED MOTION OF INDENTURE TRUSTEE FOR JEFFERSON COUNTY'S SEWER WARRANTS FOR (A) THE COURT TO ABSTAIN FROM TAKING ANY ACTION TO INTERFERE WITH THE RECEIVERSHIP CASE AND THE RECEIVER'S OPERATION AND ADMINISTRATION OF SEWER SYSTEM IN ACCORDANCE WITH THE RECEIVERSHIP ORDER, OR (B) FOR RELIEF FROM THE AUTOMATIC STAY TO THE EXTENT NECESSARY TO ALLOW RECEIVER TO CONTINUE TO OPERATE AND ADMINISTER THE SEWER SYSTEM UNDER THE RECEIVERSHIP ORDER, AND (C) REQUEST FOR EXPEDITED HEARING [Docket No. 51] (the *"Trustee Motion"* and with the Receiver Motion, the *"Motions"*) or (3) JOINDER OF CERTAIN LIQUIDITY BANKS in support of the Motions unless a different meaning is clear from the context.

147]. To the degree applicable, the Supplemental Briefs of the Indenture Trustee and Assured Guaranty Municipal Corp. also are incorporated by reference.

In furtherance of this Court's directive, the Bank Group writes to highlight certain arguments which, it is respectfully submitted, require the continued application of postpetition special revenues to pay the Parity Securities under Sections 922(d) and 928 of the Bankruptcy Code:

1) Under the law of Alabama, the warrants are an order to pay and the pledge of the net Sewer System revenues is a dedication to the warrants.

2) The County's bankruptcy does not alter this result. The interplay of Sections 902, 922(d) and 928 requires the timely payment of postpetition net special revenues of the Sewer System to the Indenture Trustee in accordance with the terms of the Indenture. No court in a chapter 9 case has ever ordered interference with the flow of special revenues.

3) While the Bank Group submits that the language of Sections 902, 922(d) and 928 is clear and unambiguous, the Court must consider the legislative history discussed in the Joinder in the absence of any controlling appellate authority and the purported ambiguity created by the County's possessory lien argument.

4) The County's stated intention in open court to stop the timely payment to the Indenture Trustee of net special revenues disregards established law specifically enacted to protect the interests of the warrantholders, including Sections 922(d) and 928, and is yet another example of the importance of leaving the Receiver in place.

I. THE PARITY SECURITIES ARE INSTRUMENTS CREATED PURSUANT TO THE MUNICIPAL LAW OF THE STATE OF ALABAMA AND THE RIGHTS OF THE HOLDERS OF THE PARITY SECURITIES THEREUNDER ARE PRESERVED UNDER SECTIONS 922(d) AND 928 OF THE BANKRUPTCY CODE

Legislative history makes clear that the 1988 Amendments were intended to remedy certain conflicts between municipal and bankruptcy law, and to confirm that parties' settled expectations with respect to special revenue bonds would not be altered in a chapter 9 case. *See* Senate Report No. 100-506, 100th Cong., 2d Sess. at 13 (1988) (the *"Senate Report"*). Accordingly, a review of the nature of the pledge supporting the Parity Securities under the municipal law of Alabama is instructive. The Parity Securities are warrants. As explained in the early Alabama case of *Littlejohn v. Littlejohn*:

> A county warrant "is the command of one duly authorized officer to another, whose duty it is to obey, to pay, from county funds, a specified sum to a designated person whose claim therefor has been allowed by the court of county commissioners.

Littlejohn v. Littlejohn, 71 So. 448, 449 (1916) (internal citations omitted).

To secure the payment of the Parity Securities, in Section 2.1 of the Indenture, the County pledged the net Sewer System revenues as further defined therein. This pledge is not, as the County erroneously asserts, a possessory lien, but rather, an irrevocable grant of funds from a specified source of revenues dedicated to pay the specified obligations. Importantly, as the Supreme Court of Alabama has stressed, a pledge "means set apart, appropriated or charged with the payment of a specific obligation authorized by law. . . . That the pledgee may, by appropriate remedy, require such revenues conserved and applied to the secured demand . . . needs no citation of authority." *Heustess v. Hearin*, 104 So. 273, 274 (Ala. 1925).

The County's argument that pledged revenues in the municipal law sense are limited to a possessory lien on revenues in the hands of the warrantholders or the Indenture Trustee is clearly

incorrect as a matter of Alabama law. *See O'Grady v. City of Hoover, Alabama*, 519 So. 2d 1292 (Ala. 1987).[3] The County's constrained reading of the word "pledge" finds no support in modern common usage of the word. The Alabama law does not require possession of property in order to have a pledged interest. The Alabama Supreme Court recognizes a pledge as existing where "legal title to the property pledged remains in the pledgor, while the pledgee *obtains a lien* or special interest in the property." *Blakeney v. Dee*, 363 So. 2d 313, 315 (Ala. 1978) (emphasis added). Because a pledgee acquires a special interest in the property itself, the pledgee holds a superior right in the property and its proceeds as against all subsequent creditors of the pledgor. *Id.* (citing *Nobles v. Christian & Craft Grocery Co.*, 20 So. 961 (Ala. 1896)). Indeed, the court has found that "[t]he effect of a contract of pledge is to leave the general property in the pledgor and invest the pledgee with a lien--a special property in the subject of the pledge." *Wood v. William*, 192 So. 421, 423 (Ala. 1939). The Alabama Supreme Court has further held that a pledge is a contract for delivery of personal property as security for the performance of an obligation. *Bailes v. First Nat. Bank of Mobile*, 281 So. 2d 632, 635 (Ala. 1973). Delivery may be made symbolically by delivery of a note representing the debt. *Id.* In essence, a pledge requires that property be dedicated in promise to pay debt.

Indeed, The Handbook of Municipal Bonds defines "pledged revenues" as "revenues legally pledged to the repayment" of, in this case, a warrant. Sylvan G. Feldstein, et al., The

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3 *See also Hall v. Underwood*, 63 So.2d 683 (1953) (addressing the Alabama Supreme Court's application of the term "pledge.") At issue in *Hall* was the constitutionality of impairment of contract provisions of a certain law that required a transfer from a county and its officials to the State Highway Department of all funds designated for the construction of roads and bridges so that the state could construct the roads and bridges. 63 So.2d at 692. The court found it clear under the act that the legislative intent was for the county to turn over only those funds designated to be used for county road and bridge purposes. The court then examined whether the new state law improperly affected certain gasoline tax warrants that were to be paid from certain pledged funds. The court determined that the new state law did not impair the obligations under the contract with warrantholders because *regardless of who had charge of the funds in question, the warrantholders would still look to the same funds for payment*. *Id*. at 693 (emphasis added).

Handbook of Municipal Bonds, 1295 (John Wiley & Sons, Inc. eds., 2008).[4] Thus, it is clear from both Alabama case law and the municipal market definition that a pledge is a dedication of specified revenue that is made by a pledgor as a promise to pay on a debt, and a possessory interest simply is not required.[5] Here, the County has pledged payment of the Sewer System net revenues to payment of the Parity Securities and, because Section 928(a) makes Section 552(a) inapplicable to liens on special revenues, the pledge has remained in place with respect to all net revenues of the Sewer System after the filing of the County's chapter 9 case. Moreover, as supported by a plain contextual reading of the statute, which is supported by the legislative history, the pledge and payment of funds on the debt are to remain unimpaired postpetition.

In summary, in the municipal finance context, a pledge is a dedication of the payment of funds to pay the recipient of the pledge. The County is required to pay the net revenues of the Sewer System to the Indenture Trustee for the benefit of the holders of the Parity Securities. As

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4 In Black's Law Dictionary (9th Edition 2009), the first-given definition of the term "pledge" is simply "a formal promise or undertaking," a definition carrying no connotation of possession or bailment. The second-given definition carries the same import as the first: "the act of providing something as security for a debt or obligation." Only in the third alternative definition does the concept of possession first appear: "a bailment or other deposit of personal property to a creditor as security for a debt or obligation." Thus, even the dictionary definition of pledge does not support the County's possessory theory. And to the extent the County believes that Congress intended the third alternative definition to apply and also to require possession, resort to the statutory structure and the Legislative history of the 1988 Amendments make short work of that contention.

5 Federal courts have also recognized that the term "pledge" is susceptible of different meanings, only one of which is "bailment for security." For example, in *United States v. Berman*, 21 F.3d 753, 756 (7th Cir. 1994), in the course of interpreting a criminal indictment charging fraud in connection with property "pledged" to the Farmers Home Administration ("*FmHA*"), the Seventh Circuit discussed the meaning of the term "pledged" as contained in Section 658 of the Farm Credit Act: "We think it fairly clear that the draftsmen of the original of Section 658 of [the Farm Credit Act] meant the term to be used broadly, that the average person who troubled to read the statute would interpret it broadly, and that the defendants therefore committed an offense within the scope of the indictment." 21 F.3d at 757. In so ruling, the Court rejected the defendants' contention that the indictment was defective because the FmHA had not had actual possession of the "pledged" collateral. To the same effect is the Court's ruling in *United States v. Henderson*, 645 F.2d 569 (7th Cir. 1981), upholding the trial court's refusal to give a jury instruction by the defendant that a "pledge" required that the pledgee have actual possession of the collateral. The Court commented: "We can take judicial notice of the fact that, although in its narrower meaning in security law a 'pledge' involves transfer of possession of collateral to the lender, in its broader usage to 'pledge' simply means to put up as collateral." Id. at 577.

set forth below, Sections 902, 922(d) and 928 of the Bankruptcy Code expressly protect the Indenture Trustee's lien on special revenues of the Sewer System in this chapter 9 case. The Bank Group submits that those sections unambiguously mandate this result. Further, and notwithstanding the County's effort to incorporate inapplicable commercial law concepts expressly rejected by Congress in enacting Sections 922(d) and 928, the legislative history of the 1988 Amendments eliminates any doubt that the unimpaired right to timely payment of special revenues is the required result.

Not surprisingly, the County has failed to discuss the clear and unequivocal nature of its obligations under Alabama law to the holders of the Parities Securities with respect to the pledged sewer revenues. With regard to the Parity Securities, under the relevant Alabama statute, it is clear that the County has no power to do anything other than to pay the net pledged special revenues to the Indenture Trustee. Section 11-28-3 of the Alabama Code mandates "pledged funds for the payment of principal of and interest on warrants" issued and declares that such funds "shall be impressed with a lien in favor of the holders of the warrants" that such pledges "shall constitute trust funds" and such pledges "shall constitute preferred claims against that portion of pledged funds so pledged and shall have preference over any other claims for any other purpose whatsoever." ALA. CODE § 11-28-3. The authorizing Alabama state law recognizes the dedication of pledged revenues as being "irrevocably pledged for the payment of the principal and interest on such warrants as provided in section 11-28-3." ALA. CODE § 11-28-2. Given the irrevocable pledge, under state law, the County cannot disturb or act contrary to the pledge and must follow the mandate to pay the net revenues of the Sewer System to the Indenture

Trustee.[6] To do otherwise would be a violation of Alabama law, the Tenth Amendment and Sections 922(d) and 928 of the Bankruptcy Code.

II. THE INTERPLAY OF SECTIONS 902, 922(D) AND 928 REQUIRES CONTINUED TIMELY PAYMENT OF THE PARITY SECURITIES

Section 902(2)(A) of the Bankruptcy Code states:

> (2) "special revenues" means -
>
> (A) receipts derived from the ownership, operation, or disposition of projects or systems of the debtor that are primarily used or intended to be used primarily to provide transportation, utility or other services, including the proceeds of borrowings to finance the projects or systems[.]

11 U.S.C. § 902(2)(A).

Pursuant to Section 902(2)(A), the revenues of the Sewer System constitute "special revenues" as they represent receipts derived from the operation of the System. These "special revenues" were pledged as security for the Parity Securities issued pursuant to the Indenture. Since the revenues of the Sewer System constitute "special revenues" under Section 902(2)(A) and are pledged pursuant to the Indenture, Sections 922(d) and 928 of the Bankruptcy Code govern their treatment in this chapter 9 case.

Section 922(d) of the Bankruptcy Code provides:

> Notwithstanding section 362 of this title and subsection (a) of this section, a petition filed under this chapter does not operate as a stay *of application of pledged special revenues* in a manner consistent

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6 Section 903 of this Bankruptcy Code recognizes the power of the State to regulate the actions of the municipality. Section 903 states that "this chapter does not limit or impair the power of a state to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise . . ." 11 U.S.C. § 903; *see generally In re Addison Cmty. Hosp. Auth.*, 175 B.R. 646 (Bankr. E.D. Mich. 1994) and *In re Pleasantview Util. Dist. of Cheatham Cnty., Tennessee*, 24 B.R. 632 (MD Tenn. 1982).

> with section [928][7] of this title *to payment of indebtedness secured by such revenues.*

11 U.S.C. § 922(d) (emphasis added). In other words, the stay does not apply and the County is required to continue to apply special revenues (i.e, the Sewer System revenues) to the payment of the indebtedness secured by such revenues in a manner consistent with Section 928.

Section 928 of the Bankruptcy Code provides:

> (a) Notwithstanding section 552(a) of this title and subject to subsection (b) of this section, special revenues acquired by the debtor after the commencement of the case shall remain subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.
>
> (b) Any such lien on special revenues, other than municipal betterment assessments, derived from a project or system shall be subject to the necessary operating expenses of such project or system, as the case may be.

11 U.S.C. § 928. Section 928(a) thus provides that special revenues acquired after the commencement of the case remain subject to any prepetition lien on such revenues. Section 552(a),[8] which *generally* operates to cut off prepetition liens from after-acquired property in bankruptcy cases, is specifically and expressly nullified in respect of special revenues (i.e., "notwithstanding section 552(a) special revenues acquired by the debtor after the case shall remain subject to the prepetition lien"). Instead of Section 552(a), which is specifically not applicable, Section 928(a) expressly provides an affirmative mandate that special revenues

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7 As the County stated in footnote 29 of its opposition to the Motions, Section 922 erroneously cites to Section 927, rather than Section 928.

8 Section 552(a) provides, "Except as provided in subsection (b) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case." 11 U.S.C. § 552(a).

acquired by the debtor after the commencement of the case *"shall remain subject to any lien [9] resulting from any security agreement [10] entered into by the debtor before the commencement of the case."* 11 U.S.C. § 928(a) (emphasis added). Thus, the prepetition lien on special revenues continues to attach to postpetition revenues acquired by the debtor. Taken together, Sections 922(d) and 928 ensure that lien and payment obligations "ride through" the bankruptcy case unaffected by the Bankruptcy Code in so far as attachment and payment are concerned.

The only statutory limitation on the postpetition operation of the prepetition lien regime is found in Section 928(b). Subsection (b) provides that "[a]ny such lien on special revenues . . . derived from a project or system shall be subject to the necessary operating expenses of such project or system." *Id*. § 928(b). The reference to "any such lien" refers to the lien mentioned in the immediately preceding subsection (a) of Section 928, i.e., the lien acquired before the commencement of the case which continues to attach to special revenues acquired by the debtor after the commencement of the case. Thus, the postpetition special revenues will be subject to the payment of necessary operating expenses of the system or project to the same extent and in the same manner as before the chapter 9 filing. If read holistically and logically, the requirement in Section 922(d) that the payments be made "in a manner consistent with section [928]," can only be read to incorporate the requirement in Section 928(b) that the continuing postpetition lien is subject to the payment of the "necessary operating expenses" of the Sewer System. So, based on the clear reading of the statutes, (1) the prepetition lien continues to attach to postpetition system revenue;

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9 "The term 'lien' means charge against or interest in property to secure payment of a debt or performance of an obligation." 11 U.S.C. § 101(37). Pursuant to Section 2.1 of the Indenture, the Debtor granted a lien (as that term is defined in the Bankruptcy Code) to the warrantholders against the System Revenues.

10 "The term 'security agreement' means agreement that creates or provides for a security interest." 11 U.S.C. § 101(50). The Indenture, which provides the warrantholders with a lien on the System Revenues, is a security agreement.

(2) there is no stay applicable; and (3) the debtor is required to continue to apply that system revenue to the payment of necessary operating expenses and then to the payment of the secured indebtedness in accordance with the debt documentation.

In a nonsensical interpretation of the word "pledge" that would render the reference to Section 928 meaningless, the County argues that the language of Section 922(d) (providing that the stay does not apply to "pledged special revenues") means that only special revenues, if any, in the actual possession of the Indenture Trustee at the beginning of the case are not affected by the stay and can therefore be applied to the indebtedness. The County bases this argument on its mistaken assumption that the reference to a "pledge" means a possessory pledge only. As set forth in the previous section, this argument completely misinterprets the meaning of a pledge under municipal and applicable Alabama law, as well as common usage of the English language. Moreover, the County's narrow reading of the phrase "pledged special revenues" as applying only to special revenues in the *actual possession* of the Indenture Trustee at the time of filing is inconsistent with the structure of municipal financing as reflected in Sections 922(d) and 928 and contradicts Congress's stated purpose in enacting the 1988 Amendments, namely, to protect the integrity of the municipal bond market.[11]

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11 The Debtor in raising the issue of a pledge being a possessory lien in relationship to Sections 922(d) and 928 is attempting to create an ambiguity in the language. For this reason alone, the Court can look to the legislative history as more fully set forth in the Joinder and in this Brief that clearly demonstrates there should be no ambiguity, that the pledge of revenues to the Parity Securities is unimpaired postpetition and that payment should be made to the warrantholders from the pledged special revenues consistent with Section 928 of the Bankruptcy Code. As Alabama case law set forth herein clearly demonstrates, a possessory pledge is not the only way a pledge can be made under Alabama law and in fact with regard to warrants, municipalities such as the County, mandate and order the dedication of the Pledged Funds to the payment of principal and interest on the warrants. Alabama Code 11-28-3 grants a lien on pledged revenues with preference over any other claim, the effect of which is the same as perfection under the Uniform Commercial Code. There is no requirement of complying with the Uniform Commercial Code because Article 9 of the UCC as promulgated in Alabama (ALA. CODE §§ 7-9A-101 *et seq*.) does not apply "to a security interest created in connection with any of its securities by this State, any municipal corporation, county, public authority, public corporation or other similar public or governmental agency or unit of this State, or political subdivision of any thereof. . . ." ALA. CODE § 7-9A-109(d)(14). The lien, trust fund and dedication of pledged revenues to payment of principal

Footnote continued.

Section 922(d) provides that the application of pledged revenue *in a manner consistent with Section 928* to prepetition secured debt is not subject to any stay. And, Section 928 has no application to special revenue already in the hands of the trustee as of the commencement of the case. Rather, Section 928 is concerned solely with after-acquired property, as its title, contextual reference to Section 552(a), and lead-in sentence state. Section 928 provides that "special revenues acquired by the debtor *after the commencement of the case* shall remain subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case." 11 U.S.C. § 928(a) (emphasis added). Section 928 by its very terms applies to ongoing revenues, not only those revenues that are in the possession of the trustee as of the petition date as maintained by the County. Section 922(d) can only be applied "consistent with" Section 928 if Section 922(d) applies to the same scope of revenues as does Section 928, and Section 928 obviously applies to after-acquired special revenues. To apply Section 922(d) in the restricted manner that the County suggests would be to apply it in a manner that is *inconsistent* with Section 928 and clearly conflicts with the legislative history. Had Congress wanted to do so, it could have added language to either Section 922(d) or to Section 928 that would have provided that the stay exclusion set forth in Section 922(d) would be applicable only to special revenues, if any, held at the time of filing. Congress did just the opposite by cross-referencing Section 928, which deals exclusively with postpetition property. Despite no specific language authorizing the flow of funds postpetition pursuant to Section 928(b), the County has no difficulty embracing the position that necessary operating expenses should be paid from special revenues postpetition. Yet the County fails to recognize the concomitant mandate of Section

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and interest on the Warrants under Alabama law is not altered postpetition pursuant to Sections 922(d) and 928 of the Bankruptcy Code.

922(d) and 928 that net special revenues flow continue to pay principal and interest on the Parity Securities postpetition. Consistency, as well as proper reading of these Bankruptcy Code sections require that Section 928 be interpreted uniformly and that the net special revenues subject to the pledge in favor of the Parity Securities continue to flow to the benefit of the holders of such securities postpetition as well[12].

In summary, Sections 922(d) and 928(b) of the Bankruptcy Code are intended to, and do in fact, work seamlessly together to protect the integrity of the municipal bond market, Congress's singular purpose in enacting the 1988 Amendments. The County's limited reading of "pledged special revenues" therefore runs afoul of Congress's intent to enact a comprehensive statutory scheme to prevent a chapter 9 bankruptcy from roiling the municipal bond market by requiring that net special revenues, whether in the possession of the County or Indenture Trustee at the time of the bankruptcy filing, or acquired postpetition, be paid.

Accordingly, and notwithstanding the filing of a chapter 9 case, Section 922(d) requires all special revenues acquired by the debtor after the commencement of the case to be applied to the payment of the indebtedness secured by the special revenues (subject to the payment of necessary operating expenses as required by Section 928(b)). The County's intentional misreading of the controlling statutory framework crafted by Congress for the express purpose of protecting the integrity of the municipal financing market -- and the scheme under which the County elected to attempt to adjust its obligations -- demonstrates why the Receiver should

12 Curiously, the County relies on an inapplicable Supreme Court decision to argue that special revenue bondholders only need be paid upon the completion of the adjustment of the County's debts. *See United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 370-71 (1988) (noting that Section 362(d)(1) of the Bankruptcy Code includes the right of a secured creditor to have a security applied to the payment of debt on the completion of a reorganization). Clearly, the *Timbers* case is inapposite here because Section 922(d) specifically exempts the application of Section 362 to special revenues, and that Congress knew and intended that result is clear from the legislative history.

continue to control the use and payment of the net sewer revenues consistent with both the Indenture and controlling state and federal law.

III. THE ELEVENTH CIRCUIT HAS REFERRED TO LEGISLATIVE HISTORY IN THE ABSENCE OF OTHER JUDICIAL AUTHORITY

The County argues that this Court may not refer to the legislative history of the 1988 Amendments because the 1988 Amendments are not ambiguous. The County has taken this obviously untenable position[13] because the legislative history so clearly rejects the interpretation that the County has urged this court to impose. The Bank Group agrees that Sections 922 and 928 unambiguously provide, after commencement of the chapter 9 case, that the rights of the Indenture Trustee and holders of the Parity Securities to receive timely payment of the net revenues of the Sewer System are unimpaired and must continue. However, the purported ambiguity created by the County's misreading of Section 922(d) is not the only recognized authorization for a review of the statute's legislative history. As set forth below, municipalities and security holders have uniformly followed the plain meaning of Sections 922(d) and 928 -- as amplified by the equally clear legislative history -- and no municipality or, as will be shown below, no chapter 9 court has ever adopted the novel interpretation offered by the County.

In situations where there is no case law on point, the Eleventh Circuit has recognized that, a court may turn to legislative history to determine Congress's intent in enacting the provision. *Hi-Tech Pharms., Inc. v. Crawford*, 544 F.3d 1187, 1190-91 (11th Cir. 2008). In *Hi-Tech*, the

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13 The voluminous pleadings and the amount of oral argument dedicated in this proceeding to the meaning of the word "pledged" in Section 922(d), and the sheer number of legal contexts presented to this Court in which the word "pledged" has been used, clearly eliminate any credible claim that the meaning of the word "pledged" in Section 922(d) of the 1988 Amendments is so "unambiguous" that the legislative history should be ignored. The Bank Group contends that when the 1988 Amendments are read in the context of their legislative history, they do indeed become "unambiguous" in the context of a chapter 9 case. The County has clearly reached the same conclusion, which is why the County continues to argue so vehemently, despite the overwhelming amount of material submitted in this proceeding to the contrary, that the Court ignore every definition and usage of the word "pledged" other than the County's narrow, non-municipal financial based and self-serving interpretation.

Eleventh Circuit analyzed, based on the text of a statute and *its legislative history*, Congress's intent in drafting a particular statute in order to settle the dispute over the proper interpretation of the provision at issue. *Id*. at 1191. Here, the use of legislative history is appropriate because there has been no judicial interpretation of the application of Sections 922 and 928 to the payment of special revenue to the holders of the obligations secured by the special revenues.[14]

Although no Court has issued a decision interpreting the application of the 1988 Amendments to payments to special revenues bondholders, one court has relied on legislative history to find that, in approving Section 928 of the Bankruptcy Code, "Congress was concerned about potential conflicts between § 552(a) and both the Tenth Amendment and the Contracts Clause [of the U.S. Constitution]." *In re County of Orange*, 179 B.R. 185, 192, n.16 (Bankr. C.D. Cal. 1995). Consulting the legislative history, as was done in *County of Orange* and as allowed by the Eleventh Circuit in *Hi-Tech*, and as discussed in depth in the Liquidity Banks' Joinder in this matter, the extensive history surrounding the 1988 Amendments makes it clear that Congress intended that holders of municipal debt secured by special revenues should continue to receive payment, less operating expenses of the project, in the event of a chapter 9 filing. *See* Senate Report at 11-12. This was the animating reason for the 1988 Amendments and no other conclusion can be drawn from the legislative history. The legislative history demonstrates that the obligation and payment of the pledged revenues are to be unimpaired and not stayed pursuant to the provisions of Section 922(d). The lien is to continue and, pursuant to

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14 No case has held that special revenues pledged to the payment of a prepetition obligation can be diverted postpetition. *See* Joinder at 10 (discussing *In re Sierra Kings Health Care Dist.*, Case No. 09-19728 [Docket No. 384] (Bankr. E.D. Cal. Sept. 13, 2010)). Further, *San Jose School District* as discussed in the Senate Report, the *Sierra Kings* case cited *infra* and *City of Vallejo* also support the continued timely payment of special revenues to the securities holders during a chapter 9 bankruptcy and that the plan cannot impair the continued, timely payment of special revenues collected postpetition. *See* Senate Report at 6 (discussing *San Jose School District)* and *In re City of Vallejo, California*, Case No. 08-26813 (Bankr. E.D. Cal. Aug., 2011) [Docket Nos. 1109 & 1045] (Second Amended Plan for the Adjustment of Debts of City of Vallejo, California, as Modified August 2, 2011 at 38 and Disclosure Statement With Respect to Second Amended Plan for the Adjustment of Debts of City of Vallejo, California, Dated May 20, 2011 at 49).

the provisions of Section 928, funds, as required by state law, are to be paid over by the County to the Trustee, and the Trustee is to apply such funds to the Parity Securities consistent with Section 928 and the terms of the Indenture.

The legislative history makes it clear that the exemption of "special revenues" from the treatment afforded other revenues in a chapter 9 pursuant to, *inter alia*, Section 922(d) was required to "accomplish what many state statutes mandate: the application of pledged revenues after payment of operating expenses to the payment of secured bonds." Senate Report at 11. Alabama Code Section 11-28-3 so mandates such an application of pledged revenues.[15]

In fact, as the Senate Report further noted:

> Reasonable assurance of timely payment is essential to the orderly marketing of municipal bonds and notes and continued municipal financing.

Id. at 21.

The clear intent of Congress in enacting the 1988 Amendments was to provide assurances to the capital markets that special revenues essential to municipal financing remain unimpaired and continue to flow in the event of a chapter 9 filing:

> To eliminate the confusion and to confirm various state laws and constitutional provisions regarding the rights of bondholders to receive the revenues pledged to them in payment of debt obligations of a municipality, a new section is provided in the amendment to ensure that revenue bondholders receive the benefit of their bargain with the municipal issuer and that they will have unimpaired rights to the project revenues pledged to them.
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> New Section 927 [928] along with the definition of Special Revenues in Section 902(3) protect the lien on revenues.

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15 Even the legislative history the County cites in its brief indicates that pledged revenues include revenues other than those in possession of the secured party. "'Pledged revenues' includes funds in the possession of the bond trustee as well as other pledged revenues." (Jefferson County's Opposition to Receiver's and Indenture Trustee's Stay Motions at 53, n.30 [Docket No. 189].) Simply stated, no intent to limit the application of special revenues can be found in the expansive language used in the 1988 Amendments and its legislative history.

Id. at 12.

IV. ANALYSIS OF THE MEANING OF "NECESSARY OPERATING EXPENSES" IN SECTION 928(b)

The County argues that Section 928(b) operates in a chapter 9 case to destroy its prepetition agreement with the Indenture Trustee and the holders of the Parity Securities and to permit the County to attempt to recast an entirely new definition of "necessary operating expenses" to be used solely on a postpetition basis in this chapter 9 case. This argument is specious and dangerous, in that it could not only produce a result that is contrary to clear Alabama law but also disrupt the municipal bond markets. While the Bankruptcy Code does not provide a definition of what constitutes "necessary operating expenses," a reading of the legislative history (as set forth below) confirms that Congress intended that when a security agreement, such as the Indenture, provides for the payment of operating expenses ahead of debt service, then the terms of the Indenture should apply rather than the "minimum standard" set forth in Section 928(b).

In discussing Section 928(b), the Senate Report provides:

> Necessary operating expenses are expenses which are necessary to keep the project or system going and producing special revenues. Prepetition operating expenses are included to the extent payment is deemed necessary by the court for this purpose.

Senate Report at 22. Furthermore,

> *The intent of Subsection (b) is not to change the priority and intent of the use of special revenues under the terms of the municipal debt financing documents.*
>
> Subsection (b) sets forth a *minimum standard* for paying operating expenses ahead of debt service where revenues are pledged. It is not intended to displace any broader standard contained in the terms of the pledge or applicable non-bankruptcy law. The operating expenses are to be necessary and directly related to the

> project or system generating the special revenues and are not the expenses of the municipality generally or for other systems or projects.

Id. at 23 (emphasis added).

Here, the Indenture has been in effect since 1997 and specifically provides the definition of what constitutes "Operating Expenses" that must be deducted from the pledged System Revenues. Section 2.1 of the Indenture provides, in pertinent part that:

> . . . the County does hereby grant, bargain, sell and convey, assign, transfer and pledge to and with the Trustee the following described properties, interests and rights of the County, whether the same are now owned by it or may be hereafter acquired: (I) The System Revenues (other than revenues derived from the Sewer Tax and any other tax revenues that constitute System Revenues) that remain after the payment of Operating Expenses . . . .

Indenture § 2.1.

Article 1.1 of the Indenture sets forth the definition of "Operating Expenses":

> "Operating Expenses" means for the applicable period or periods, (a) the reasonable and necessary expenses of efficiently and economically administering and operating the System, including, without limitation, the costs of all items of labor, materials, supplies, equipment (other than equipment chargeable to fixed capital account), premiums on insurance policies and fidelity bonds maintained with respect to the System (including casualty, liability and any other types of insurance), fees for engineers, attorneys and accountants (except where such fees are chargeable to fixed capital account) and all other items, except depreciation, amortization, interest and payments made pursuant to Qualified Swaps, that by generally accepted accounting principles are properly chargeable to expenses of administration and operation and are not characterized as extraordinary items, (b) the expenses of maintaining the System in good repair and in good operating condition, but not including items that by generally accepted accounting principals are properly chargeable to fixed capital account, and (c) the fees and charges of the Trustee. Payments or transfers of Sewer Revenues into the General Fund of the County shall constitute payments of Operating Expenses if and to the extent that the services or benefits for which such payments or transfers are made are such that payments to a

> Person other than the County for such services or benefits would constitute payments of Operating Expenses.

Id. § 1.1.

The Indenture clearly provides that a pledge is granted to the Indenture Trustee on the "System Revenues . . . that remain after the payment of the Operating Expenses." *Id*. § 2.1. The definition of "Operating Expenses" specifically excepts *depreciation and amortization*. Consequently, these items must not be deducted from the System Revenues when applying Section 928(b). If the Court believes there should be any variance from the language of the Indenture in respect of the calculation of net special revenues available for payment of the Parity Securities, the Bank Group requests the opportunity to provide evidence and further briefing of this issue since it was not raised in the Motions or at the evidentiary hearing.

V. SPECIAL REVENUES HAVE CONTINUED TO BE PAID TO HOLDERS OF SPECIAL REVENUE PLEDGES IN OTHER CHAPTER 9 PROCEEDINGS

Consistent with the clear Congressional mandate, no bankruptcy court in a chapter 9 case has ever found that special revenues can be taken and used by a municipality contrary to the pledges under state law and the contractual rights of warrantholders.[16] In fact, chapter 9 courts have recognized the mandate of Sections 922(d) and 928 that special revenues continue to be paid to the obligations for which they have been pledged (namely, principal and interest on the warrants). In the *Vallejo* case, the special revenue securities were paid timely throughout the case and were unimpaired under the Plan. In *In re Heffernan Memorial Hospital District*, the

16 As set forth above, under applicable state law, including the nature of the warrants and the provisions of Alabama Code Section 11-28-3, the County does not have the authority to use the pledged net revenues for anything other than payment of the principal and interest on the Parity Securities. As a result, the County's contention that "adequate protection" could somehow justify ignoring the clear dictates of Sections 922(d) and 928 and a violation of state law by holding hostage net special revenues is clearly without merit. Adequate protection is simply not a relevant consideration in this context, and if it were, it certainly would support timely payment of net special revenues in compliance with Sections 922(d) and 928. In any event, if it were to apply, it would require the County's timely compliance with the Indenture, as mandated under Sections 922(d) and 928.

Bankruptcy Court determined that because a sales tax revenue stream pledged and assigned to a City was not available for general municipal purposes, the pledge in question was a pledge of special revenues under chapter 9. 202 B.R. 147, 149 (Bankr. S.D. Cal. 1996). In *In re Sierra Kings Health Care District*, the Court entered an order reaffirming that bonds were secured by special revenues, subject to a statutory lien and must be paid, and have in fact continued during the chapter 9 case to be paid, pursuant to their terms as funds were collected and could not be used for other purposes. Case No. 09-19728-B-9 (Bankr. E.D. Cal. Sept. 13, 2010) [Docket No. 384]. Debt service on special revenue indebtedness always has been maintained during that chapter 9 case.

Even prior to the 1988 Amendment, pledged revenues under state law that were the equivalent to special revenues were recognized to be payable only to the holders of the securities. In *In re San Jose Unified School District,* Case No. 5-83-02387-A-9 (Bankr. N.D. Cal 1983), the School District allowed the tax funds that had been collected to be used to pay the interest payment which was due at the time the School District filed its chapter 9 proceeding and thereafter.

This was specifically noted in the Senate Report in explaining why Sections 922(d) and 928 fulfilled the mandate of state law and the U.S. Constitution:

> The application of Section 552 in a Chapter 9 bankruptcy proceeding may also defy practical reality and state law mandates. As in the case of the San Jose School District, *In re San Jose Unified School District*, No. 5-83-02387-A-9 (B.C.N.D. Cal. 1983), the continued payment of interest to bondholders not only helped ensure the debtor's continued access to credit markets but also helps fulfill the requirement of state law that such collected funds be used to pay bondholders. Cal. Educ. Code Ann. 15251.

Senate Report at 6.

Thus, Congress has mandated that the prepetition *status quo* is to be maintained postpetition and the flow of net special revenues as pledged to the Indenture Trustee and

ultimately paid to the holders of the warrants is to be continued postpetition unimpaired. This is mandated by the Alabama authorizing statute for the issuance of the Parity Securities and by Sections 922(d) and 928 of the Bankruptcy Code and is consistent with the legislative history to chapter 9 and the 1988 Amendments. Anything less than that result will deprive the holders of the Parity Securities of the benefit of their bargain and will lead to dire consequences in the municipal capital markets and result in the exact harm that Congress sought to avoid in enacting the 1988 Amendments.

CONCLUSION

WHEREFORE, for all the reasons set forth herein and in the Joinder, the Bank Group respectfully suggests that, under applicable law, and the relevant legislative history, the payment of special revenues pledged to the Indenture Trustee on behalf of the Parity Securities must continue unimpaired postpetition. There is no basis under applicable law to support the contention of the County that the flow of special revenues can be interfered with. The unprecedented suggestion of the County that the special revenues can be diverted or delayed strongly supports the granting of the Motions and the maintenance of the Receiver so such unprecedented actions being contemplated by the County do not become a reality.

Respectfully submitted on this the 2nd day of December, 2011.

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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

In re:	:	CASE NO. 11-05736-TBB-9
JEFFERSON COUNTY, ALABAMA	:	CHAPTER 9
DEBTOR.	:	

CERTIFICATE OF SERVICE

I, Stephen B. Porterfield, do hereby certify that on the 2nd day of December, 2011, I caused a copy of the within Brief of the of the Bank Group Concerning Sections 922 and 928 of the Bankruptcy Code be served through the ECF system, and that copies will be sent electronically to registered participants as identified on the Notice of Electronic Filing (NEF) and paper copies will be sent to those indicated as non-registered participants as of the date herein.

Date: December 2, 2011

/s/ Stephen B. Porterfield